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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF DAVID DAVIES, DECEASED, BY MABEL L. DAVIES, EXECUTRIX, AND H. W. JAMESON AND JOHN L. DAVIES, EXECUTORS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit, entered in the above entitled case on March 5, 1942, reversing the decision of the United States Board of Tax Appeals (R. 29).

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 7–14) is reported at 42 B. T. A. 965. The opinion of the Circuit Court of Appeals (R. 25–28) is reported at 126 F. (2d) 294.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 5, 1942 (R. 29). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer obtained an injunction in 1935 against the collection of processing taxes imposed under the Agricultural Adjustment Act. The Act was declared unconstitutional by this Court early in January 1936, and the taxpayer never paid the processing taxes in question. The question presented is whether he was nevertheless entitled to deduct such processing taxes from his gross income for 1935, merely because he kept his books on the accrual basis of accounting.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
> In computing net income there shall be allowed as deductions:
> * * * * *
> (c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, except—
> [here follow immaterial exceptions]
> * * * * *

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 43–2. *When charges deductible.*— * * * Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compen-

> sation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. * * *

STATEMENT

The facts, as found by the Board of Tax Appeals (R. 8–12), may be summarized as follows:

The respondents are the executrix and executors of the estate of David Davies, whose income taxes for the year 1935 are here involved, and who will hereinafter be referred to as the taxpayer.

During 1935 the taxpayer was engaged in the slaughtering of hogs, which was subject to the processing taxes imposed under the Agricultural Adjustment Act. He kept his books on the accrual basis of accounting, and this case raises the question whether he was entitled to deduct such processing taxes in his income returns for 1935, nothwithstanding that he never paid the processing taxes in question. Those processing taxes relate to the months February through November 1935, and were in the aggregate amount of $124,910.69. The taxpayer had obtained an injunction against the collection of those taxes; for the months February–June, the taxes (aggregating $59,049.44) were

deposited in escrow, and for the months July–November, the taxes (aggregating $65,861.25) were not even paid to the escrow agent.

The Agricultural Adjustment Act was declared unconstitutional on January 6, 1936 in *United States* v. *Butler,* 297 U. S. 1; and on January 13, 1936, this Court further held that the result was not altered by certain amendatory legislation and that taxes impounded *pendente lite* were to be restored. *Rickert Rice Mills* v. *Fontenot,* 297 U. S. 110, 694. Thus, the $59,049.44 which the taxpayer herein had deposited with the escrow agent were returned to him on January 18, 1936.

The taxpayer's income tax returns for the year 1935 were due on March 15, 1936, and respondents here assert that the taxpayer was entitled to deduct those processing taxes placed in escrow which were returned to him as well as the processing taxes for the months July-November which were not even placed in escrow. The Board of Tax Appeals denied the deduction, but the court below reversed.[1]

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[1] There was also involved before the Board the processing taxes for December in the amount of $17,823.83 (R. 12) for which the Board also denied a deduction. The court below affirmed the Board on this item because the taxpayer had not filed any processing tax return for December. He had filed returns for each of the other months in controversy and the taxes disclosed on those returns were abated on March 14 and March 22, 1936 (R. 10).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the taxpayer is entitled to a deduction from gross income for the taxable year 1935 of the amount of $124,910.69 on account of the unpaid processing taxes for the period February–November, 1935;

2. In failing to hold that the taxpayer is not entitled to such deduction;

3. In reversing the decision of the Board of Tax Appeals.

REASON FOR GRANTING THE WRIT

The court below erroneously held that the taxpayer was entitled to a deduction from gross income in 1935 on account of processing taxes which he was then vigorously contesting and the collection of which he had successfully prevented through an injunction. Sections 41 and 43 of the Revenue Act of 1934 both provide in effect that the system of accounting employed by the taxpayer must "clearly reflect" his income. In holding that the taxpayer may take a deduction for a contested liability which he in fact never became obligated to pay, the court not only permitted a treatment of that liability which did not "clearly reflect" income but which was contrary to the basic principles of the accrual system of accounting as

recognized by the decisions of this Court,[2] of the lower courts,[3] and of the Board of Tax Appeals.[4] In determining whether a deduction for a tax may be accrued, the pivotal consideration is whether "all the events" have occurred "which fix the amount of the tax and determine the liability of the taxpayer to pay it." *United States* v. *Anderson,* 269 U. S. 422, 441. But here, all the events relating to the taxpayer's liability for processing taxes did not occur in 1935, for the most important of those "events" was the outcome of his litigation in which he was vigorously contesting liability and which in fact finally terminated in his favor

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[2] Thus, in *Lucas* v. *American Code Co.*, 280 U. S. 445, 451, the Court held, *inter alia*, that a taxpayer which had committed a breach of contract in 1919 could not accrue any deduction in 1919 on account of liability for the breach where it "strenuously contested" that liability, and where judgment for that liability was not entered against it until 1922.

[3] Although not squarely in conflict, a number of lower court decisions indicate an understanding of the accrual system of accounting that is inconsistent with the decision herein. See, *e. g.*, *J. N. Pharr & Sons, Ltd.* v. *Commissioner*, 56 F. (2d) 832 (C. C. A. 5th); *Kentucky & Indiana T. R. Co.* v. *Commissioner*, 54 F. (2d) 738 (C. C. A. 6th); *H. Liebes & Co.* v. *Commissioner*, 90 F. (2d) 932 (C. C. A. 9th).

However, two decisions seem to be broadly inconsistent with the Government's theory and are in accord with the decision below. *J. A. Dougherty's Sons* v. *Commissioner*, 121 F. (2d) 700 (C. C. A. 3d); *Commissioner* v. *Central United Nat. Bank*, 99 F. (2d) 568 (C. C. A. 6th).

[4] *Eckert Packing Co.* v. *Commissioner*, 42 B. T. A. 1000; cf. *Rex Machinery & Supply Co.* v. *Commissioner*, 3 B. T. A. 182.

in 1936. The holding of the court below that the taxpayer was entitled to accrue those processing taxes in 1935 is plainly contrary to the fundamental principles of accrual accounting. Cf. *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 93–94.

The issue has become one of increasing importance in the administration of the revenue laws. The Treasury has advised us that it in fact knows of 273 pending cases raising the same issue which involve an aggregate of over $7,500,000 in taxes, and it is of the opinion that a complete survey of its files would disclose many more cases of this type.

In view of the importance of the issue, it is respectfully submitted that this petition should be granted.

CHARLES FAHY,
Solicitor General.

JUNE 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942

IN THE

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BRIEF CONTRA GRANTING PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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Citations.

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No. 1283.

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Petitioner,

vs.

ESTATE OF DAVID DAVIES, DECEASED, BY MABEL L. DAVIES, EXECUTRIX, AND H. W. JAMESON AND JOHN L. DAVIES, EXECUTORS.

BRIEF CONTRA GRANTING PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

QUESTION.

Whether taxpayer was entitled to deduct from income in 1935 the amount of processing taxes which were assessed against him and payable by him under the Agricultural Adjustment Act during that year and accrued upon his books during that year.

STATEMENT OF FACTS.

David Davies, during the year 1935, operated a meat packing and slaughtering establishment in Columbus, Ohio. His books were kept on the accrual basis and his income tax return for the year 1935 was filed on the same basis.

During the year 1935 an act, known as the Agricultural Adjustment Act, was in full force and effect. By virtue of that act a processing tax was levied on the slaughter of hogs and, inasmuch as David Davies slaughtered hogs, he was subject to that tax.

Section 19(a) of the Agricultural Adjustment Act provided that, after a processing tax had gone into effect on any basic agricultural commodity, this tax should be collected by the bureau of internal revenue under the direction of the secretary of the treasury.

Section 626 of the Revenue Act of 1932, c. 209, 47 Stat., 169, made applicable by Section 19(b) of the Agricultural Adjustment Act, **provided that every person liable for the processing tax should make monthly returns, under oath, in duplicate and that the taxes should be paid to the collector of internal revenue of the district** in which the taxpayer was located.

Section 626(b) of the Revenue Act of 1932 made applicable by Section 19(b) of the Agricultural Adjustment Act, **provided that the tax should be due and payable at the time of filing of each monthly process tax return without assessment by the commission or notice from the collector.**

In accordance with these provisions, David Davies filed with the collector of internal revenue for the

Eleventh District of Ohio processing tax returns on the processing of hogs monthly for the months of February through November, 1935. As each return was filed, David Davies entered as an accrual on his books the amount of the tax listed on the return debiting "merchandise purchases, hog tax" and crediting "accounts payable."

On August 29, 1935, pursuant to an application by David Davies, the District Court of the United States for the Southern District of Ohio, Eastern Division, granted a temporary injunction against the collector of internal revenue, restraining him from collecting from David Davies the processing taxes assessed, and ordered that David Davies deposit in escrow an amount equal to the processing taxes claimed by the collector from David Davies.

Pursuant to that order, David Davies paid into escrow $59,049.44 which represented processing taxes assessed for the months February, March, April, May and June of 1935. The processing taxes for the months of July through November of 1935, in the total amount of $65,-861.25, reported monthly, were not paid in escrow nor were they paid to the collector of internal revenue. As before stated, all of these amounts were accrued upon the David Davies' books in 1935.

On January 6, 1936, the Supreme Court of the United States, in **United States v. Butler**, 297 U. S., 1, held the Agricultural Adjustment Act to be unconstitutional. Thereafter the aforesaid amount of escrow money was returned to David Davies and the second amount was abated.

David Davies, in his income tax return for the year 1935, entered as a deduction from income the aforesaid

amounts of processing tax accrued upon his books for that year.

The United States Circuit Court of Appeals, Sixth Circuit, held that the deduction was proper, reversing a previous contrary decision by the United States Board of Tax Appeals.

REASON FOR DENYING THE WRIT.

The fundamental principle upon which the court below based its decision was that a deduction for an accrual of a tax levied, assessed and payable under a tax statute, which was in full force and effect during the entire year in question, is an allowable deduction from income on the income tax return for that year even though the constitutionality of the tax statute was contested by the taxpayer in that year.

This is in direct accord with the decision by the United States Circuit Court of Appeals, Third Circuit, in **J. A. Dougherty Sons v. Commissioner**, 121 F. (2d), 700, which involved exactly the same fact situation as is found in the case at bar.

The taxpayer, in the case at bar, filed his income tax returns (including the one for 1935) on the accrual basis. He had accrued upon his books for 1935 the processing tax on hogs levied under authority of the Agricultural Adjustment Act which was fully enforced during the entire year of 1935. The taxpayer was required to, and did, make monthly returns in 1935 of the amount of tax due and, under the provisions of the act, the tax was due and payable without assessment when each return was filed. The taxpayer, therefore, entered these accrued taxes as a deduction in his income tax return for 1935.

The court below considered these facts in the light of the well established rule that, in order for an accrual of an obligation to be allowable, all events must have occurred which fix the amount of the obligation and determine the liability of the taxpayer to pay it. The court found that the amount of the accrued tax in question was definite (and it should be noted that petitioner has never questioned the fact that the amount is fixed, nor has he ever questioned the accuracy of the amount). The court then found that a tax levied by a sovereign authority for a year certain is a definite liability and that, by virtue of the assessment of the tax and the accrual of the tax on the books of the taxpayer, all events had occurred which fixed the liability for the tax. This coincides exactly with the reasoning in the Dougherty case.

The petitioner, in his opening brief, contends that the court below erred in its conclusions and cites, as his principal authority, **Lucas v. American Code Co.**, 280 U. S., 445, 451. We respectfully point out that this case involved a claimed deduction arising out of a pending action for breach of contract between two private individuals. In addition, the decision of the court was based solely on the fact that the amount of the deduction was not definite since it could not be ascertained until the controversy as to the amount had been finally settled.

In the case at bar there is no question as to the definiteness of the amount of the deduction. The contest involved here is over the validity of a public law, an entirely different situation from a contest growing out of a private transaction subject to private compromise and adjustment. The fact situations in the two cases are, therefore, entirely different and are in no way compar-

able. In the **Dougherty case, supra**, the opinion carries this statement:

> "The difference in certainty of liability between a levied tax and an ordinary fiscal obligation seems to us to be self-evident."

The court below followed to the letter the fundamental principle as to the allowance of a deduction for an accrued tax which was laid down in **United States v. Anderson**, 269 U. S., 422, 441. The yardstick used was exactly the same in the case at bar, the **Lucas case** and the **Anderson case.** The results however were different because the fact situations were entirely different. There is, therefore, no conflict between the court below and the previous holdings of the Supreme Court as to the law to be applied.

The petitioner has cited a number of other cases in his brief. Each of these cases has a fact situation comparable to that of the **Lucas case.** They all involve claimed deductions arising out of unsettled or litigated private controversies. Not one of them concerns a public tax law. They do not present a situation comparable to that of the case at bar and, therefore, are not applicable to the present question.

The petitioner's sole contention is that the act of the taxpayer in contesting the validity of the tax law in question thereby rendered his liability to pay the tax a contingent one. A logical consideration of the question reveals that that fact does not make the liability a contingent one, nor does it change the date upon which the tax is due. The law itself determines the liability and the date when the tax is due. It is a sovereign mandate. The enactment of the law makes it an established fact upon which, and only upon which, the amount of and

liability for a tax can be based. It is no private agreement between two individuals who can alter it at any time, nor does it create a situation wherein there can be a compromise or settlement as to the amount due or the liability to pay. The law is fixed and definite. The facts to which the law must be applied, to determine the amount of and the liability for the tax, have all occurred. There is nothing more which can occur to affect the amount or liability as it stood in the light of that law in the year in question. In short, "all events" have occurred which "fix the amount of the tax and determine the liability of the taxpayer to pay it," and a contest by the taxpayer, as to the validity of the law, in no wise affects those facts.[1]

The petitioner attempts to emphasize the importance of this case on the basis that there are pending a number of similar cases involving a large amount of taxes. The inference seems to be that if this case is not reversed the tax will be lost.

We wish to emphasize that this is not correct. The decision of the court below merely means that the amount of deduction allowable in 1935 automatically becomes additional income in 1936 since the escrow was refunded and the tax abated in 1936. This means that, actually, an additional tax will be assessed against the taxpayer in 1936. The tax, therefore, will not be lost.

In conclusion, we respectfully submit that there has been no departure from a logical application of the income tax law to accrual accounting in the case at bar;

[1]A number of decisions have followed this reasoning in addition to the case at bar and the Dougherty case, supra—Continental Baking Co. v. Helvering, 77 F. (2nd), 119; Russell Miller Milling Co., 69 F. (2nd), 392; Hygienic Products Co. v. Commissioner, 37 B. T. A., 202; Bartles Scott Oil Co. v, Commissioner, 2 B. T. A., 16; Great Northern Railway Co., 30 B. T. A., 691.

that there is no other issue of great importance involved, and that, therefore, the petition should be denied.

Respectfully submitted,

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